

Material for
Staff Presentation to the
Federal Open Market Committee

February 9, 1988

PRINCIPAL ASSUMPTIONS

Monetary Policy Objectives

1. Policy aims at maximum sustainable output and employment growth, avoiding a significant acceleration of inflation.
2. Policy does not seek to constrain exchange rate movements, unless they seriously jeopardize attainment of objective 1.

Implies:

- Interest rates unchanged to a bit lower through midyear, but moving up moderately thereafter.
- M2 and M3 in the middle portion of the tentative ranges for 1988 and growing more slowly in 1989.
- The dollar likely will decline at a moderate rate through the end of the forecast period.

Fiscal Policy

No significant changes in fiscal policy beyond those contemplated in the FY88–89 deficit-reduction package agreed to in December.

Federal Budget Deficit

Billions of dollars			
	FY87	FY88	FY89
Original Gramm-Rudman Target	144	108	72
Revised Gramm-Rudman Target	n.a.	144	136
Congressional Budget Office	148	157	176
Board Staff	148	159	146

FEDERAL BUDGET DEFICIT

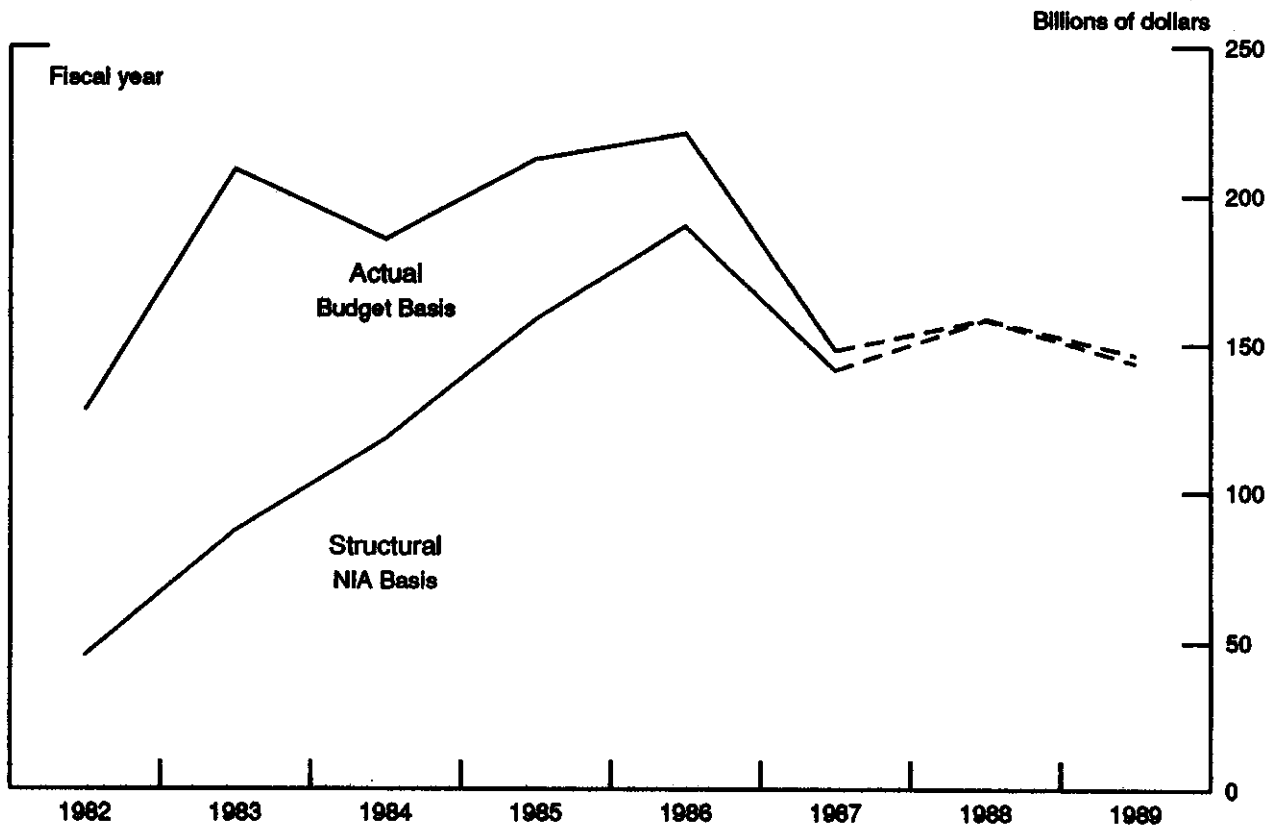
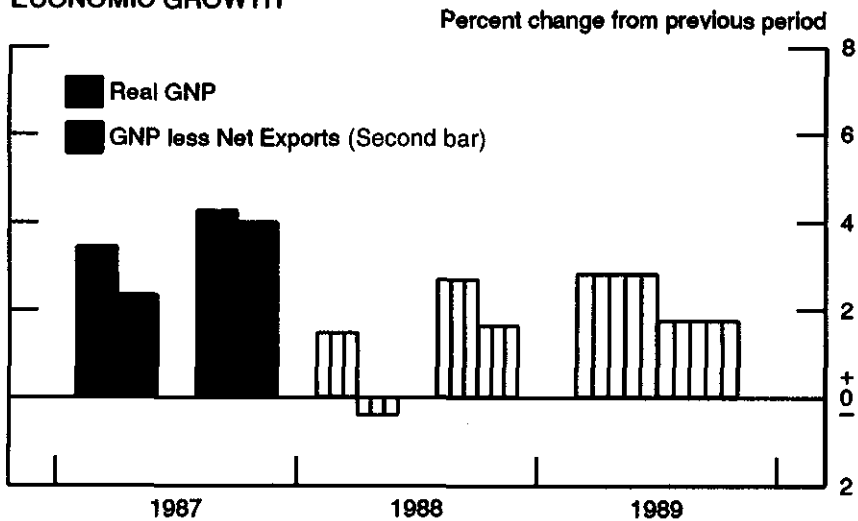


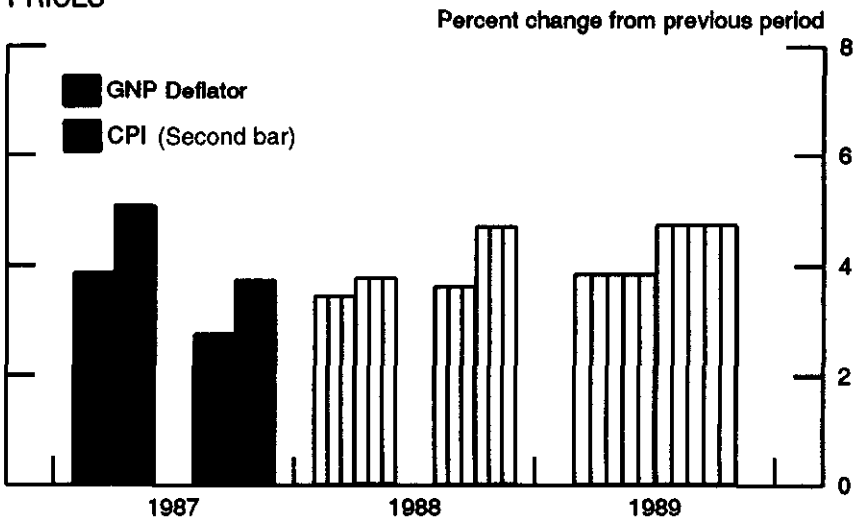
Chart 3

ECONOMIC GROWTH



	Percent change Q4 to Q4	
	GNP	GNP less Net Exports
1986	2.2	2.7
1987	3.8	3.2
1988	2.1	.6
1989	2.8	1.7

PRICES



	Percent change Q4 to Q4	
	Deflator	CPI
1986	2.2	1.3
1987	3.3	4.4
1988	3.5	4.2
1989	3.8	4.7

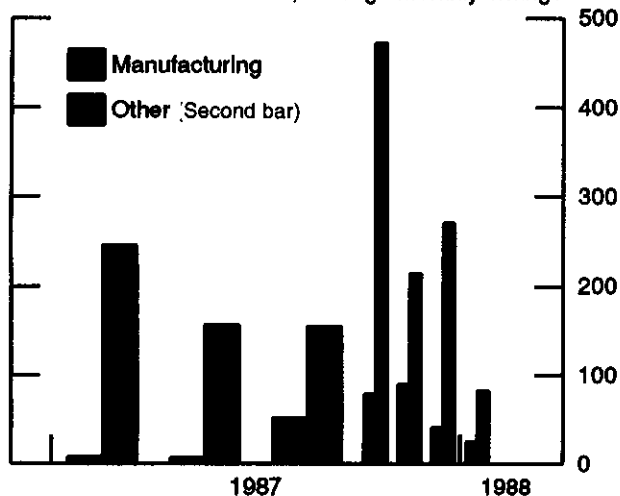
Economic Projections for 1988

	FOMC Range	Central Tendency	Adminis- tration	Staff
Percent change, Q4 to Q4				
Nominal GNP	4 to 6½	5¼ to 6	6.4	5.7
Real GNP	½ to 3	2 to 2½	2.4	2.1
GNP Deflator	2½ to 4	3¼ to 3¾	3.9	3.5
Average level, Q4, percent				
Unemployment Rate	5½ to 6¾	5¾ to 6	5.8	6.0

Chart 4

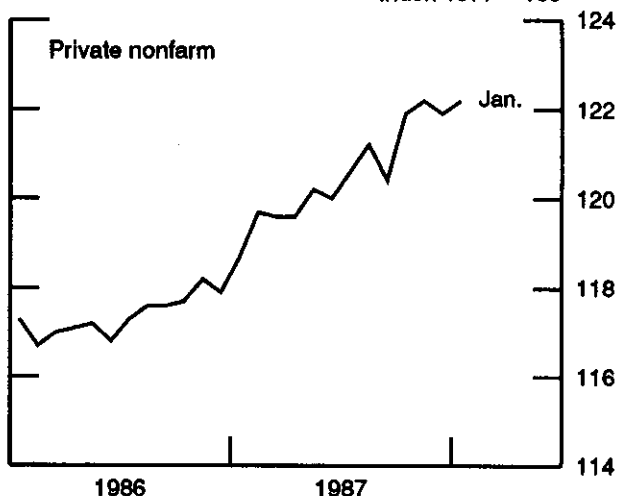
PAYROLL EMPLOYMENT

Thousands, average monthly change



PRODUCTION WORKER HOURS

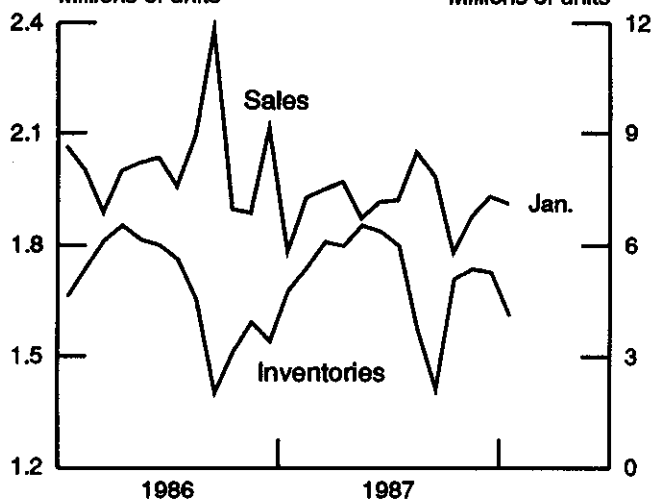
Index 1977 = 100



AUTO SALES AND INVENTORIES

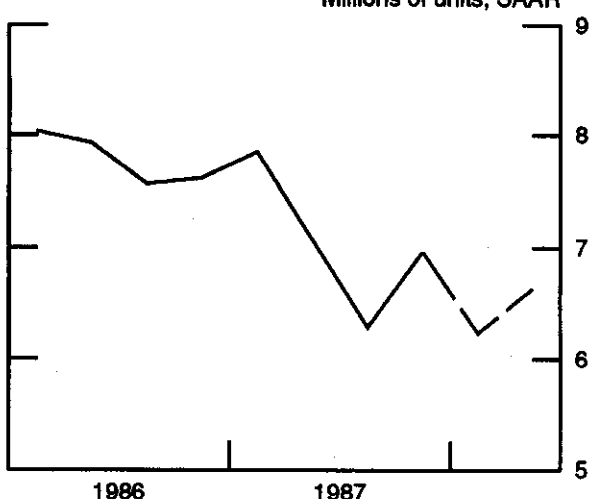
Millions of units

Millions of units



AUTO PRODUCTION

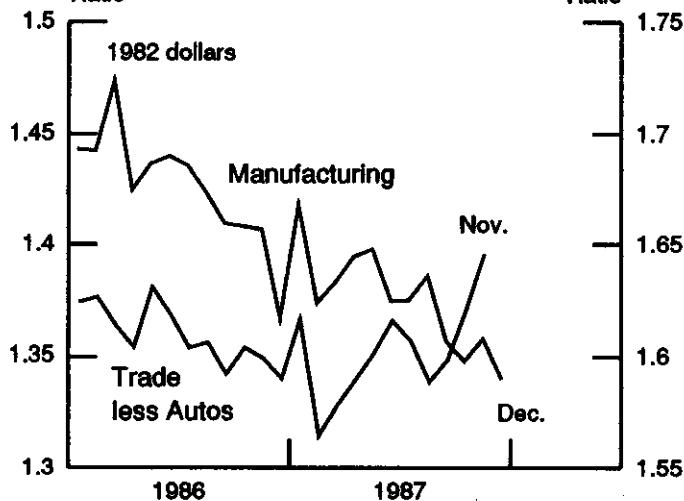
Millions of units, SAAR



BUSINESS INVENTORY-SALES RATIOS

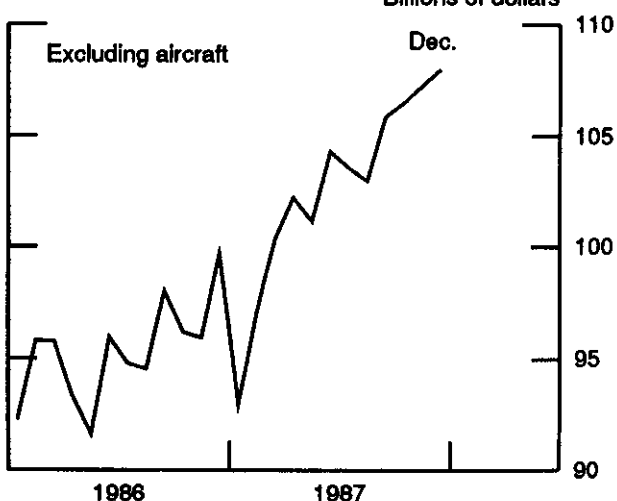
Ratio

Ratio



MANUFACTURERS' NEW ORDERS *

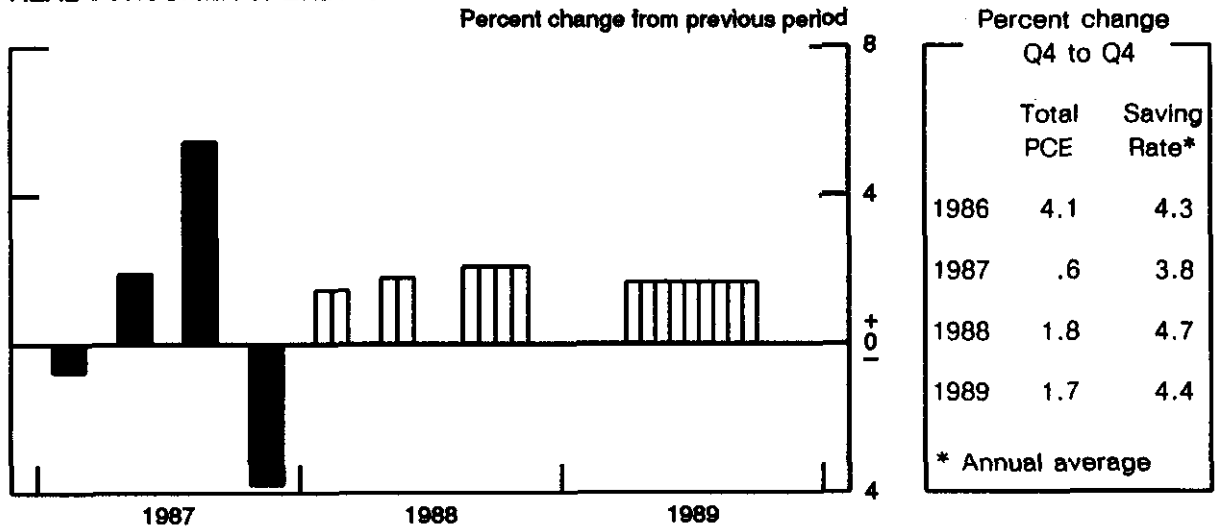
Billions of dollars



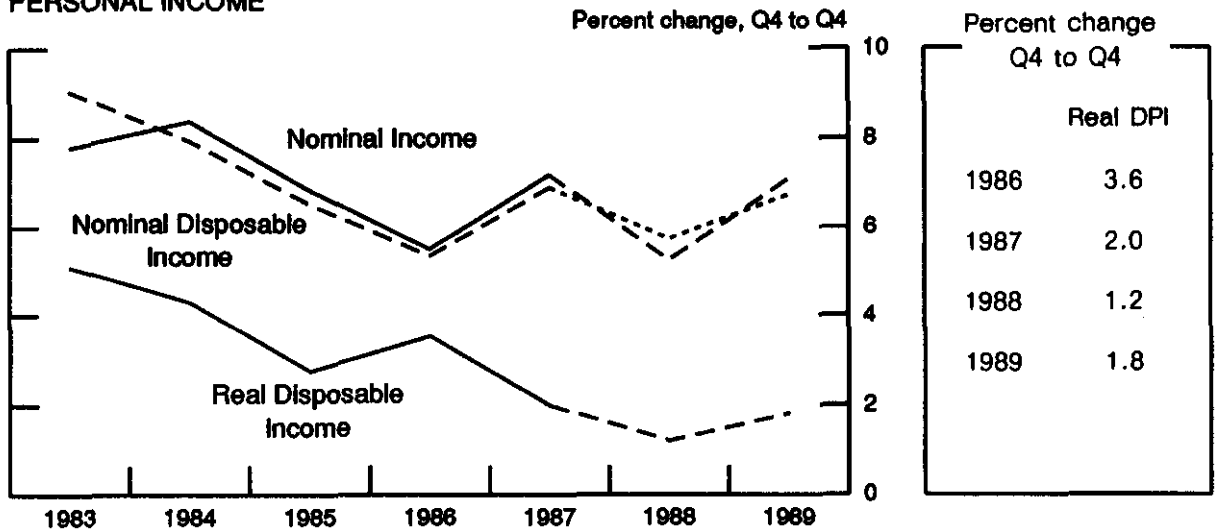
* Industries with unfilled orders data.

Chart 5

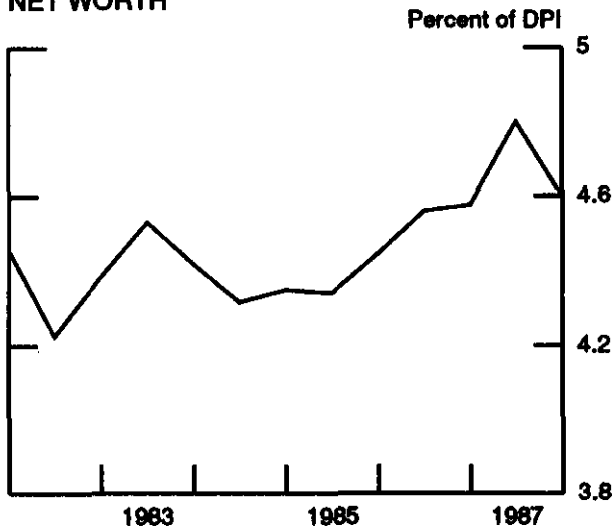
REAL CONSUMER SPENDING



PERSONAL INCOME



NET WORTH



CONSUMER SENTIMENT

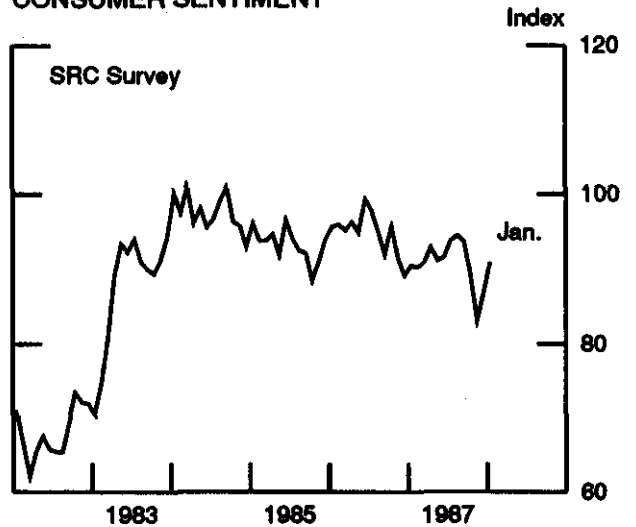
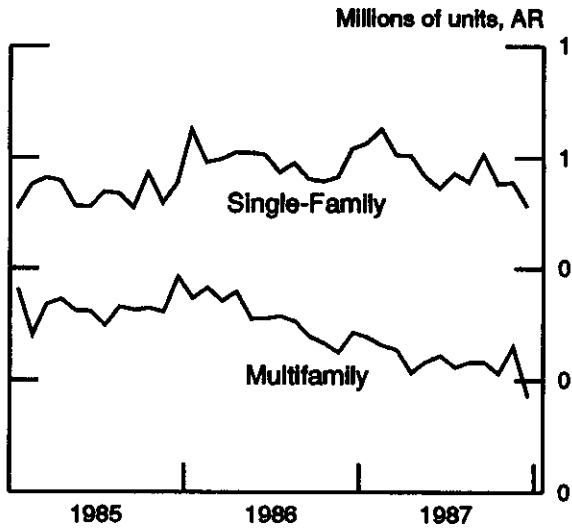
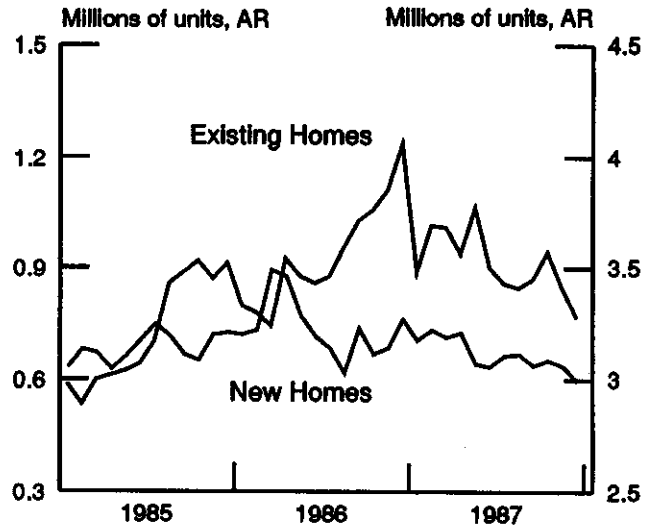


Chart 6

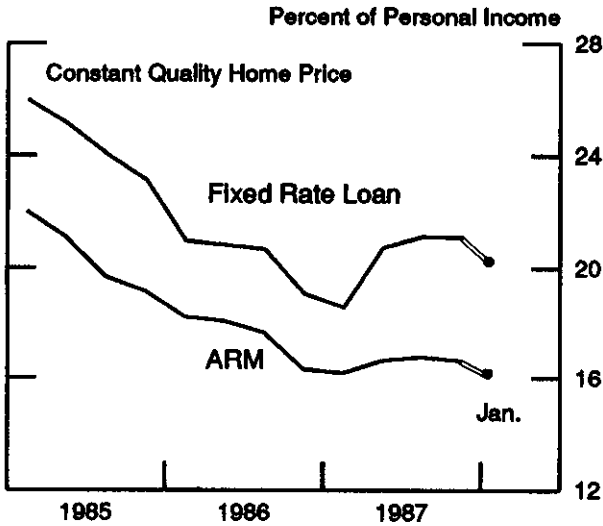
HOUSING STARTS



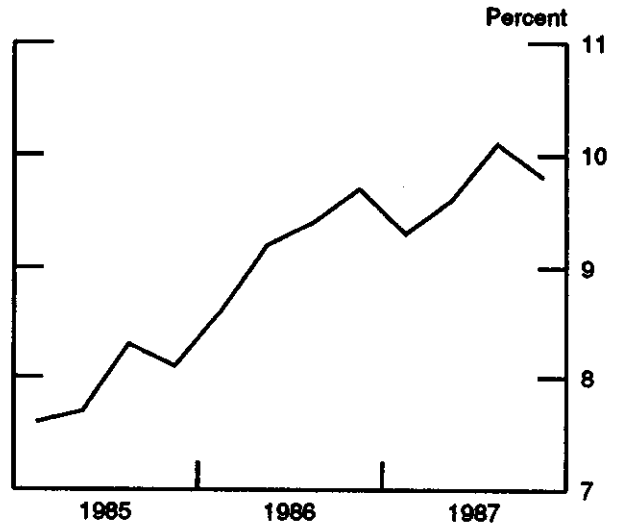
HOME SALES



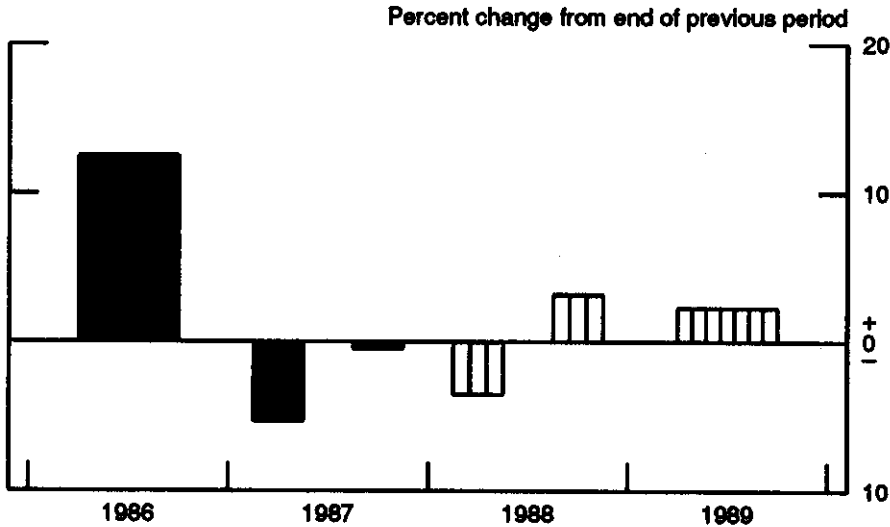
MORTGAGE PAYMENT ON NEW HOME



MULTIFAMILY RENTAL VACANCY RATE



REAL RESIDENTIAL INVESTMENT

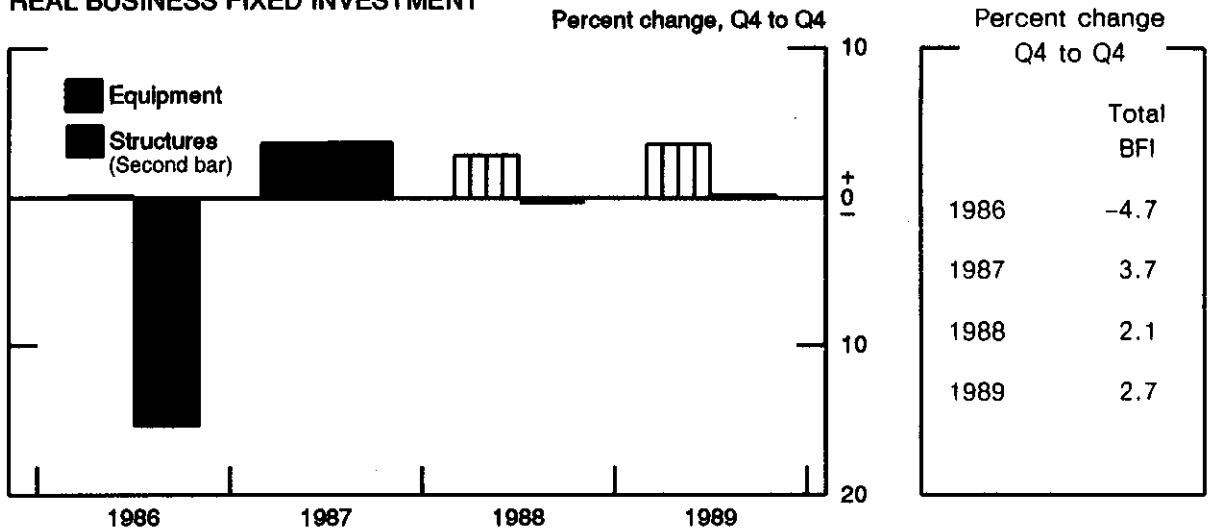


Residential Investment

Net change Q4 to Q4	
	Total
1986	12.5
1987	-2.9
1988	-.2
1989	2.3

Chart 7

REAL BUSINESS FIXED INVESTMENT

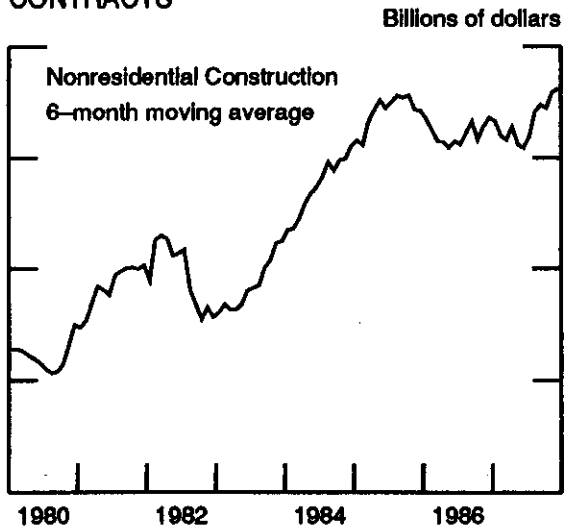


Capacity Utilization Rates

	Percent		
	1978-80 high	Dec. 1986	Dec. 1987
Manufacturing	86.5	80.2	82.2
Durable	86.3	77.3	79.8
Steel	100.3	64.7	89.6*
Nondurable	87.0	84.4	85.8
Paper	92.7	93.9	97.8*
Chemicals	82.9	81.2	84.4*
Textiles	88.3	90.8	94.1*

* Preliminary unpublished data

CONTRACTS



VACANCY RATES

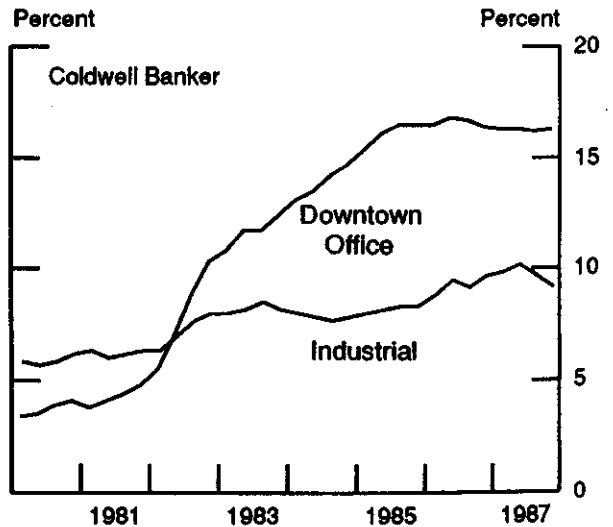
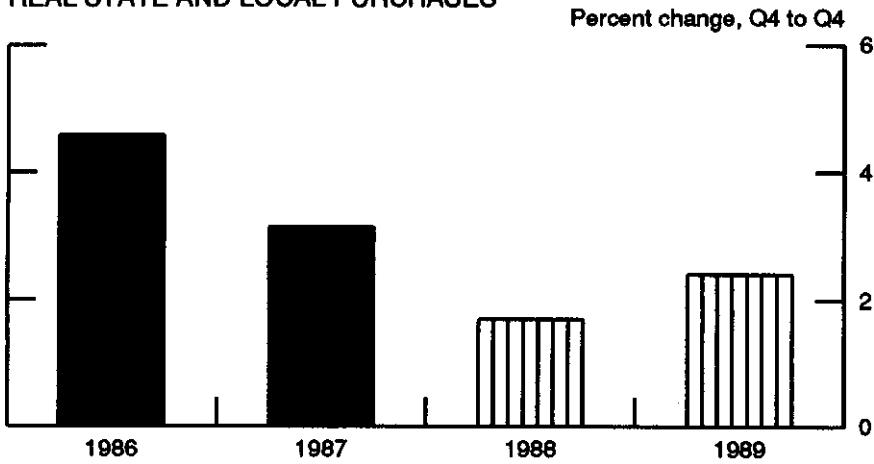


Chart 8

REAL STATE AND LOCAL PURCHASES

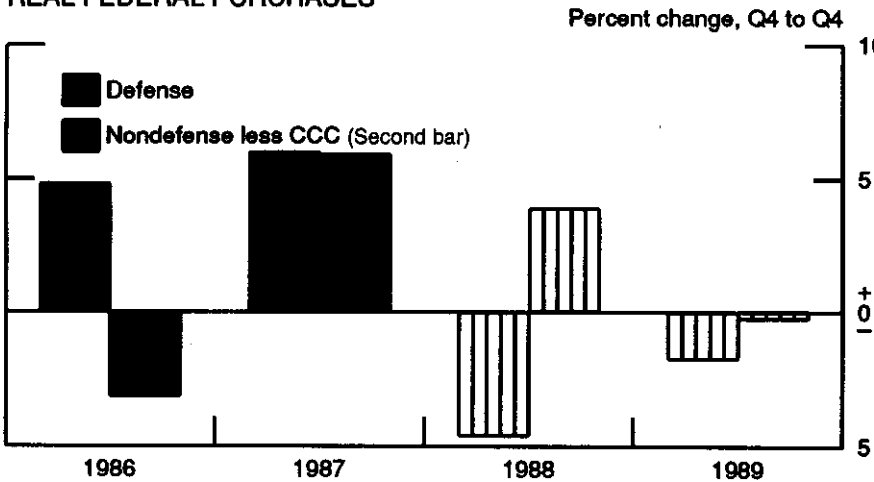


Billions of dollars

Surplus less
Trust Funds

1986	7.5
1987	-6.4
1988	-4.6
1989	3.5

REAL FEDERAL PURCHASES



Percent change
Q4 to Q4

Total
Purchases

1986	-0.2
1987	2.9
1988	-5.0
1989	-1.4

Total Funds Raised

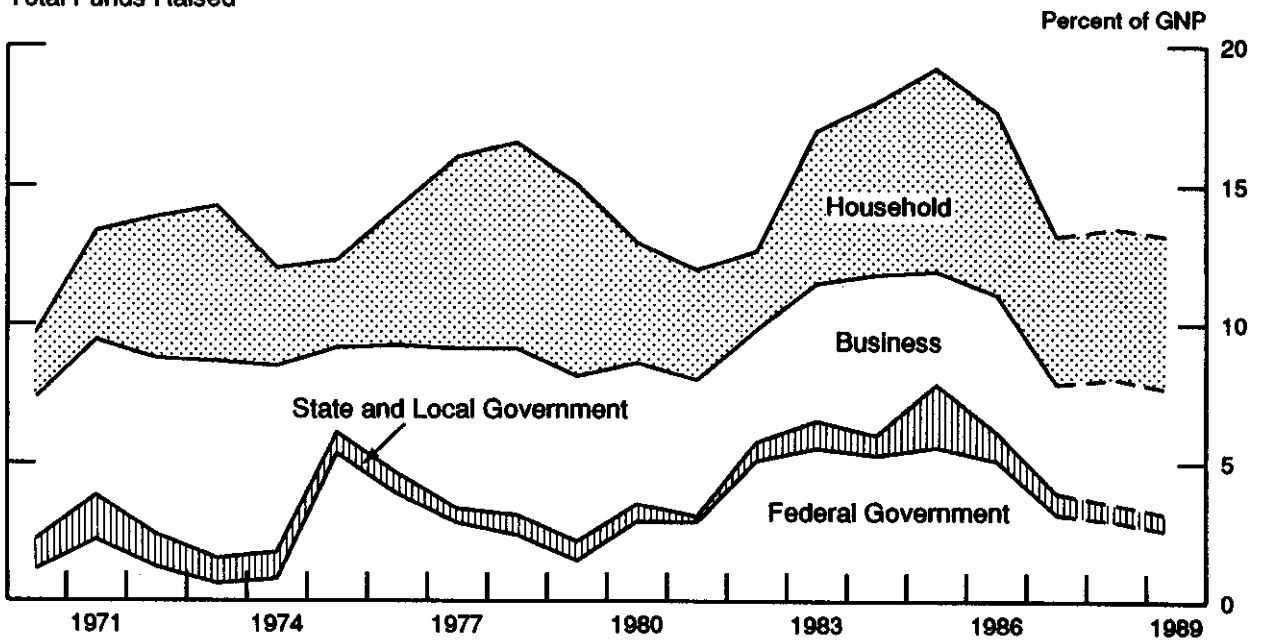


Chart 9

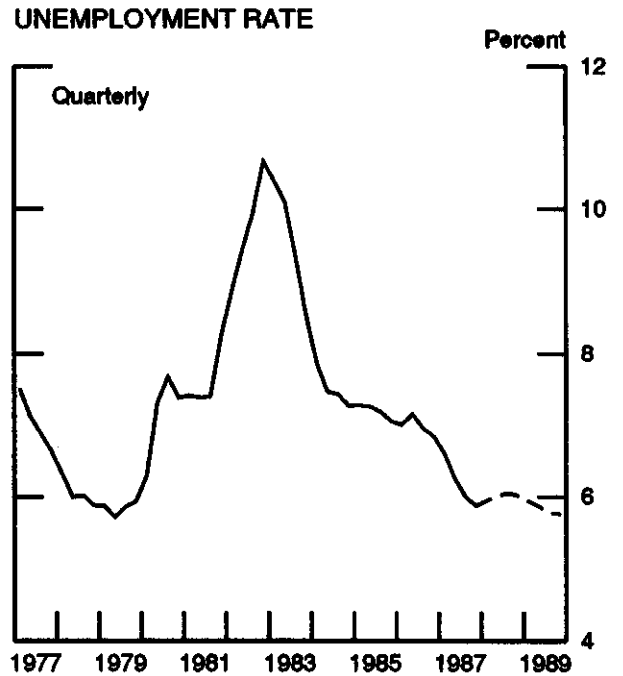
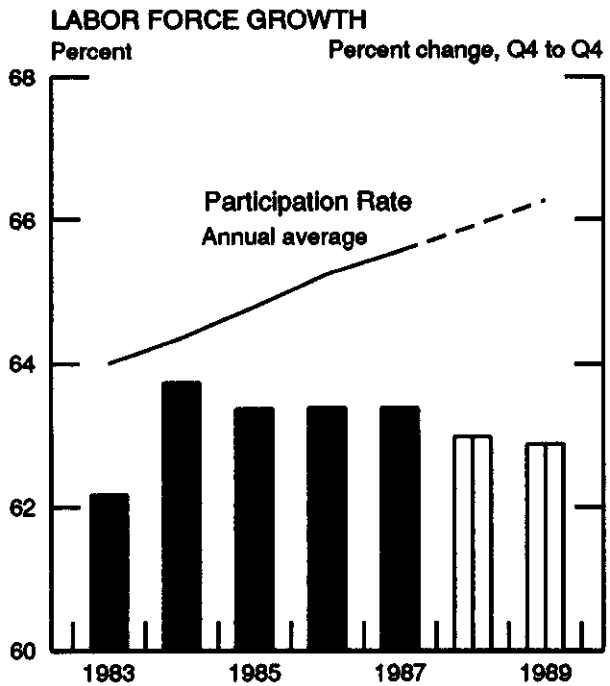
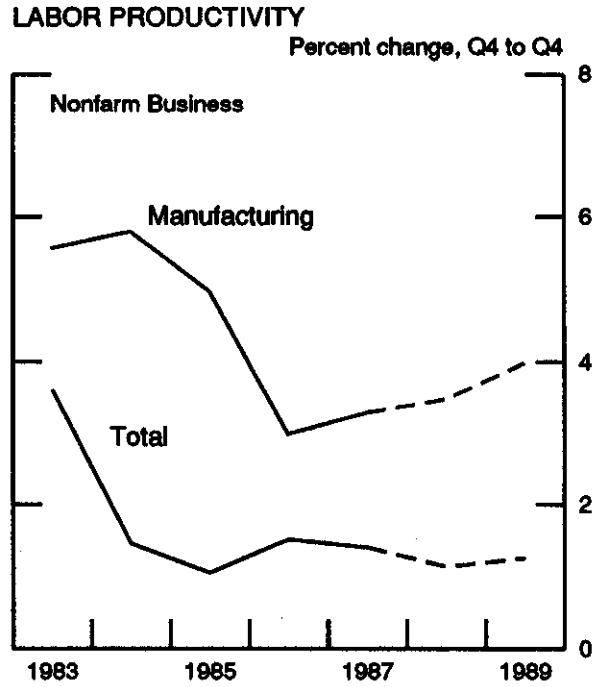
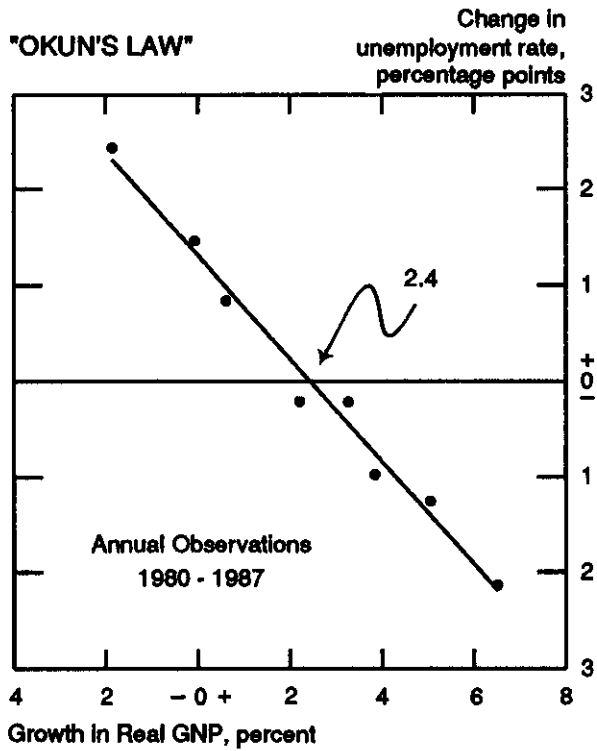
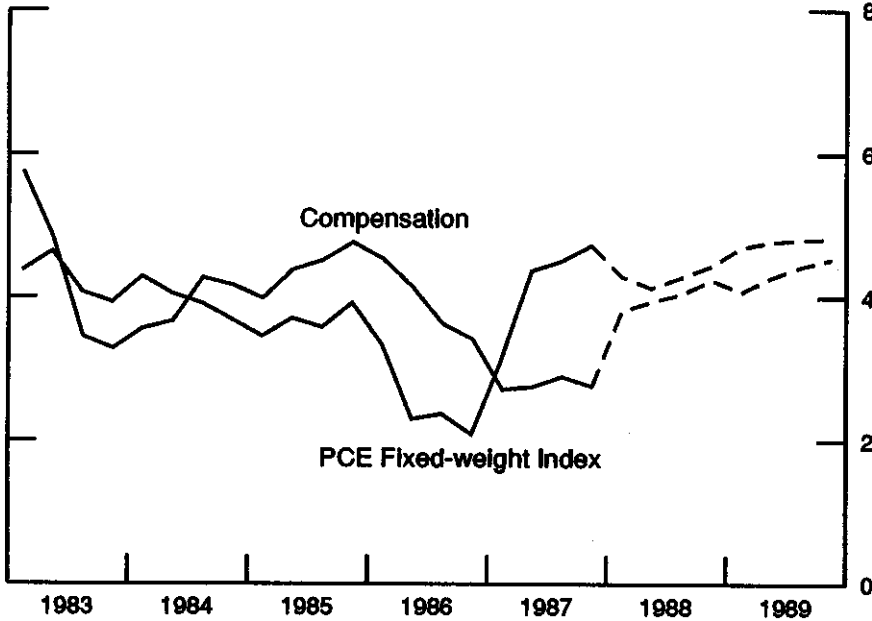


Chart 10

COMPENSATION PER HOUR AND CONSUMER PRICES

Percent change from four quarters earlier

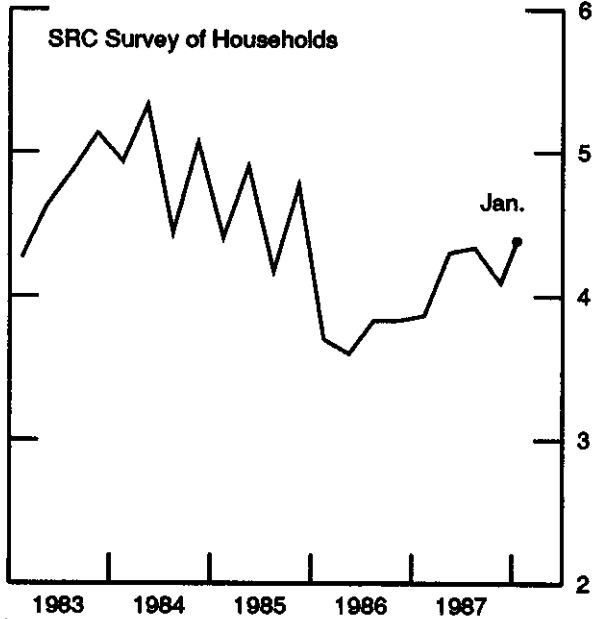
Compensation per Hour



	Percent change Q4 to Q4	
	Real	Nominal
1985	.8	4.8
1986	1.3	3.4
1987	-1.9	2.8
1988	-.2	4.2
1989	-.3	4.5

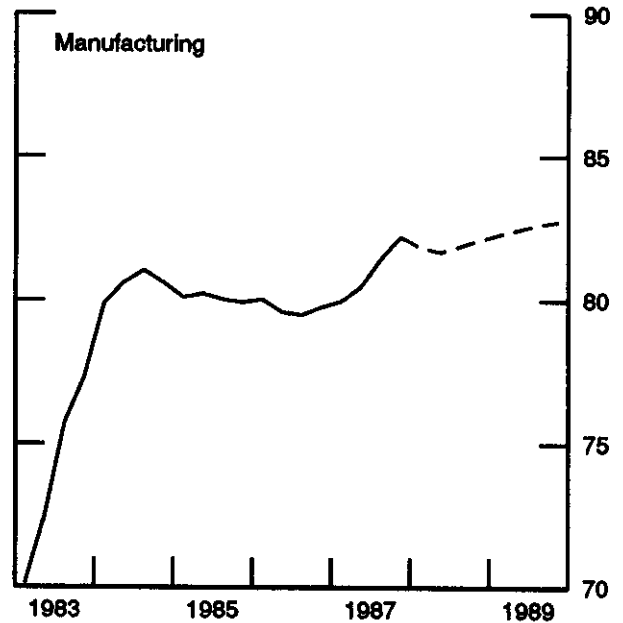
EXPECTED INFLATION

Percent change over
next 12 months



CAPACITY UTILIZATION

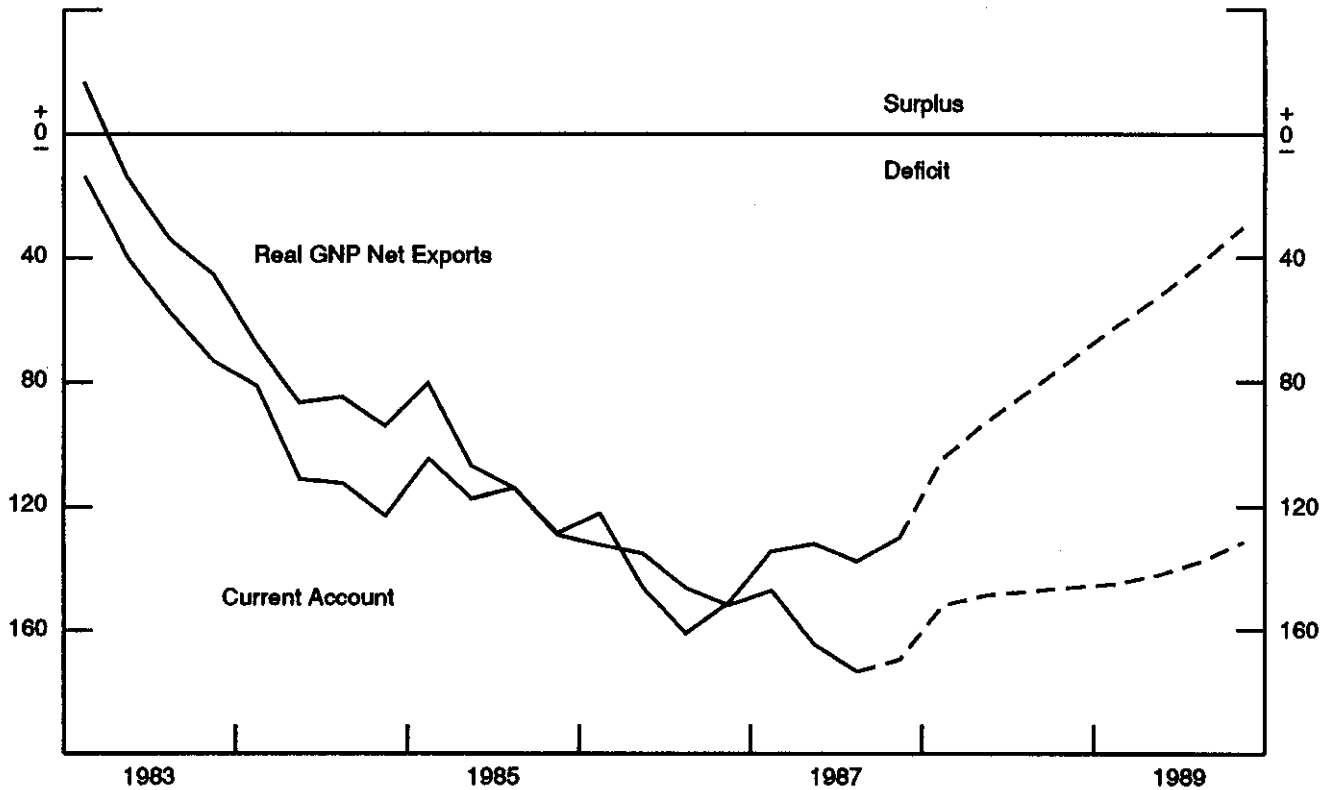
Percent



EXTERNAL BALANCES

Billions of 1982 dollars

Billions of dollars

**Components of Real Net Exports of Goods and Services**

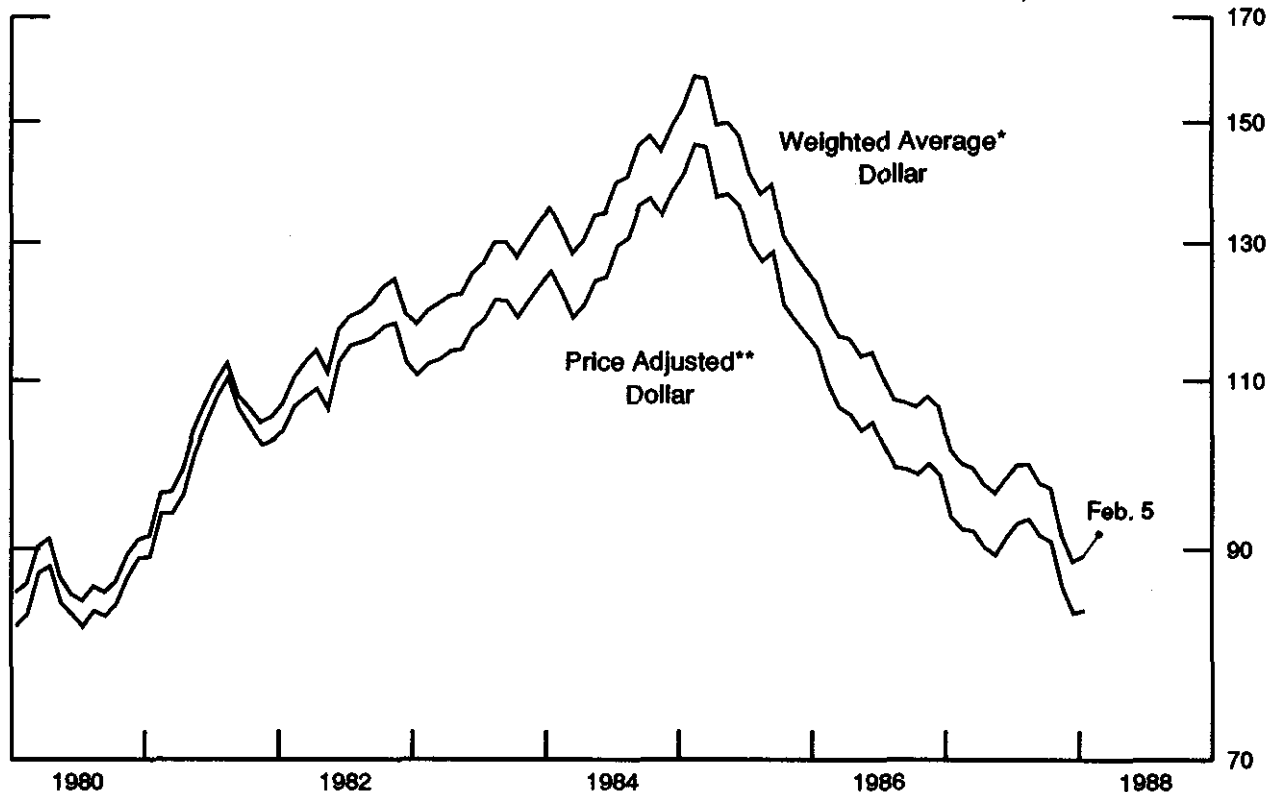
Percent change, Q4/Q4

	1986	1987	1988	1989
Exports of Goods and Services	6	17	15	15
Goods	10	20	19	17
Services	-2	11	7	11
Imports of Goods and Services	9	8	2	6
Goods	11	6	2	5
Services	1	18	0	12

Chart 12

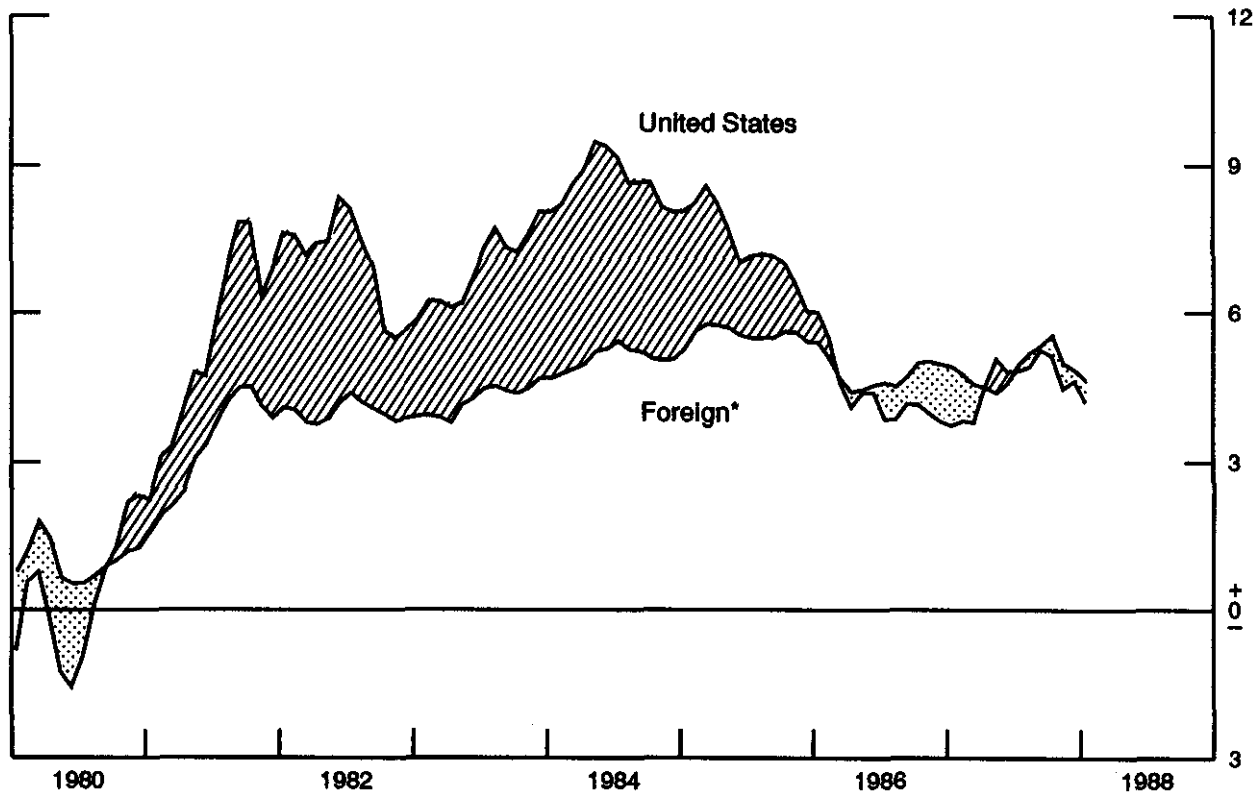
FOREIGN EXCHANGE VALUE OF THE U.S. DOLLAR

Ratio scale, March 1973=100



REAL LONG TERM INTEREST RATES ***

Percent



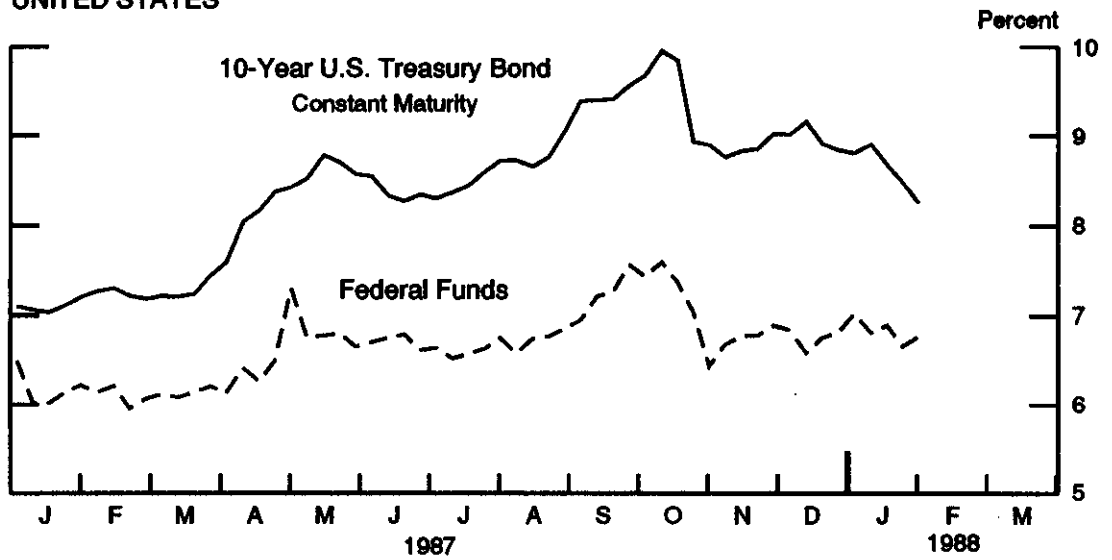
* Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

** Adjusted by relative consumer prices.

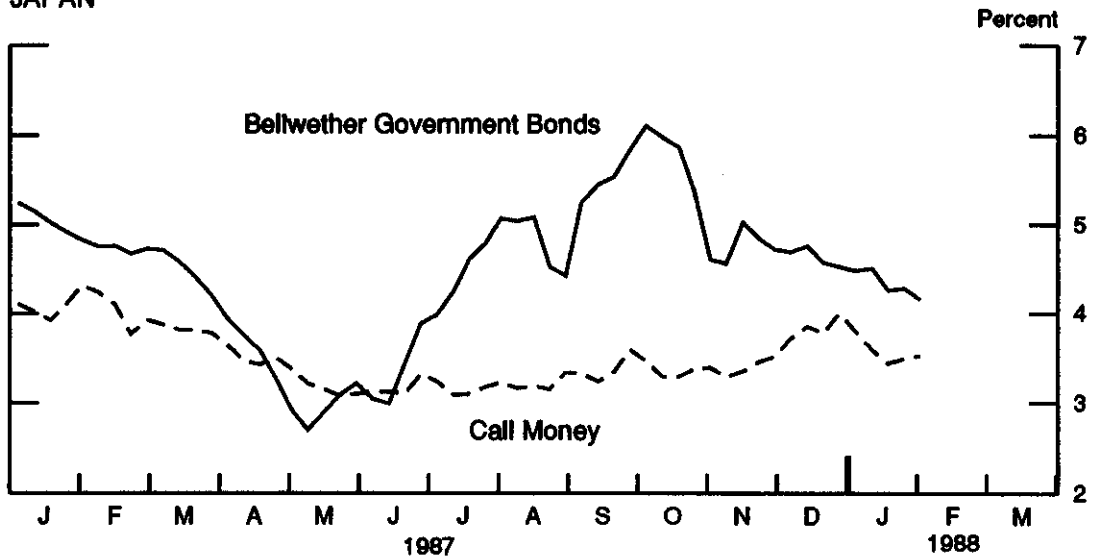
*** Multilateral trade-weighted average of Long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

Recent Trends in Interest Rates

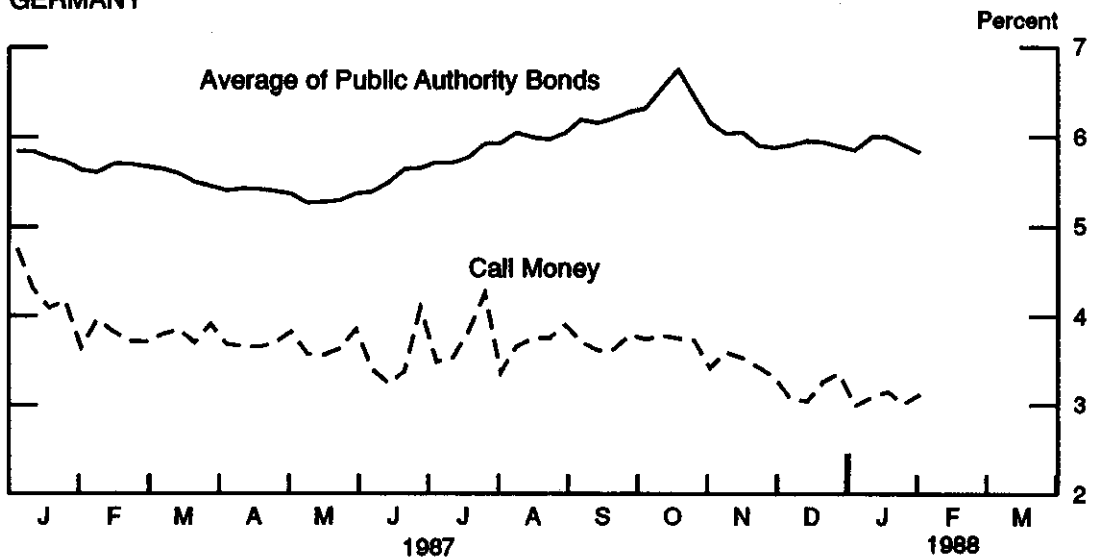
UNITED STATES



JAPAN

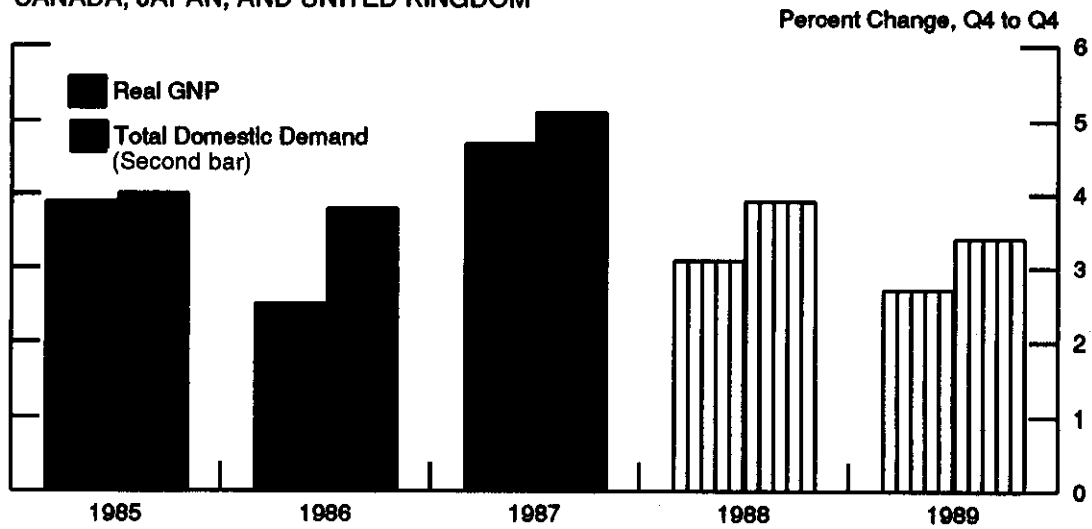


GERMANY

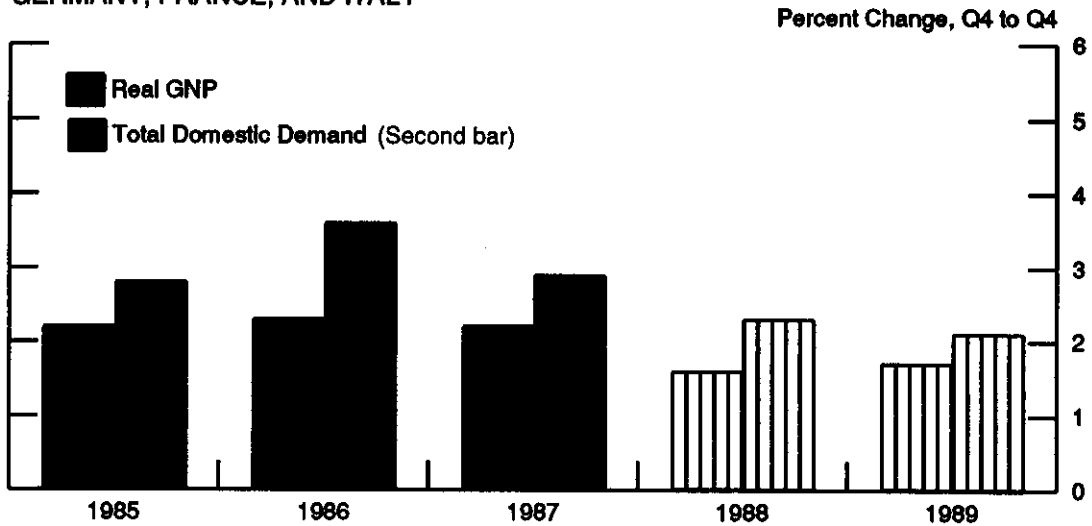


ECONOMIC ACTIVITY

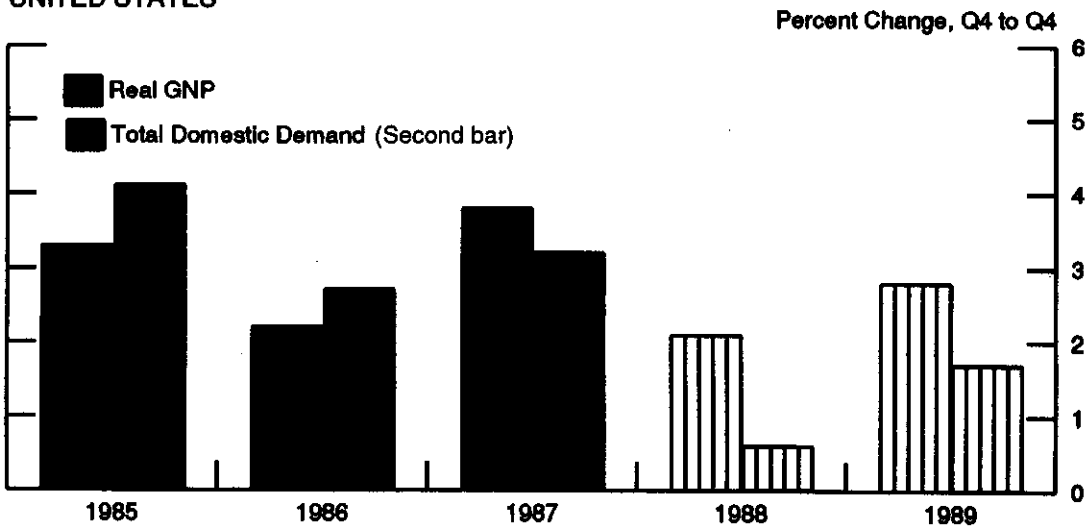
CANADA, JAPAN, AND UNITED KINGDOM *



GERMANY, FRANCE, AND ITALY *

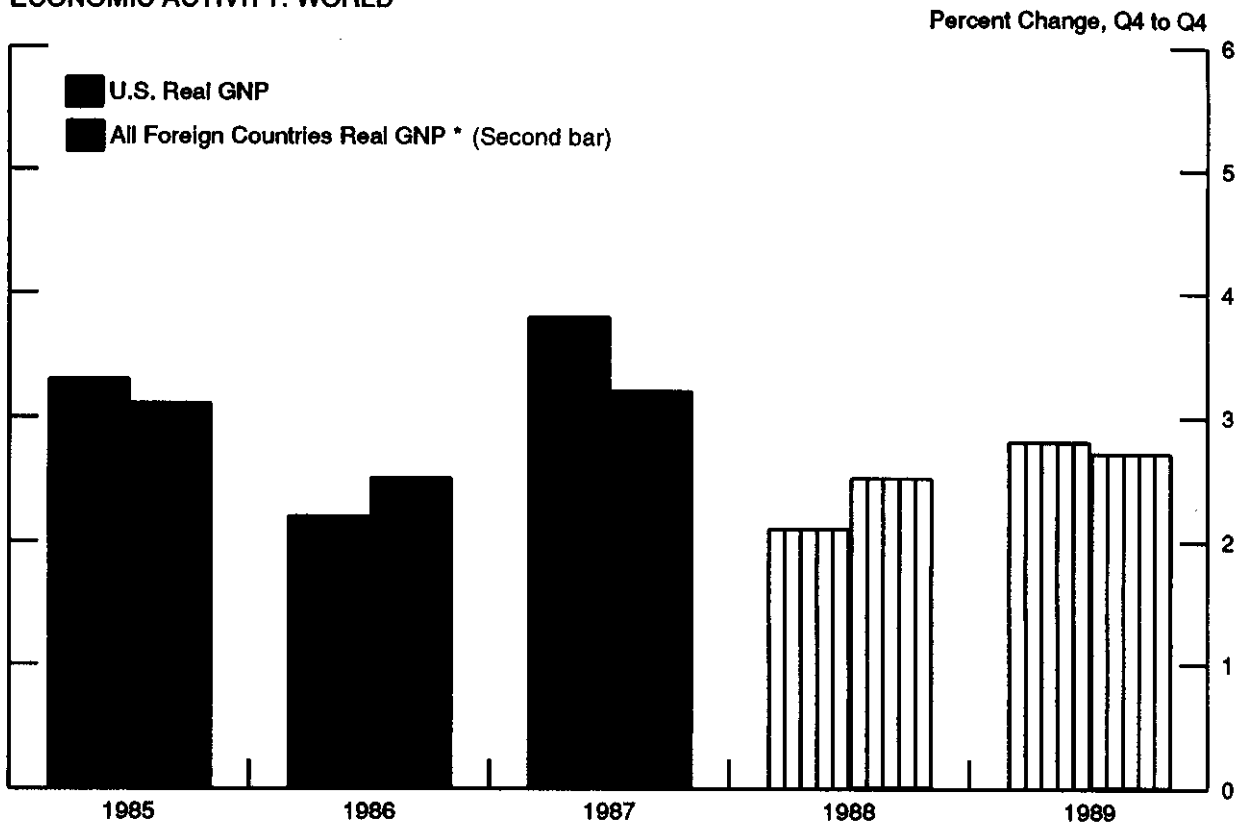


UNITED STATES

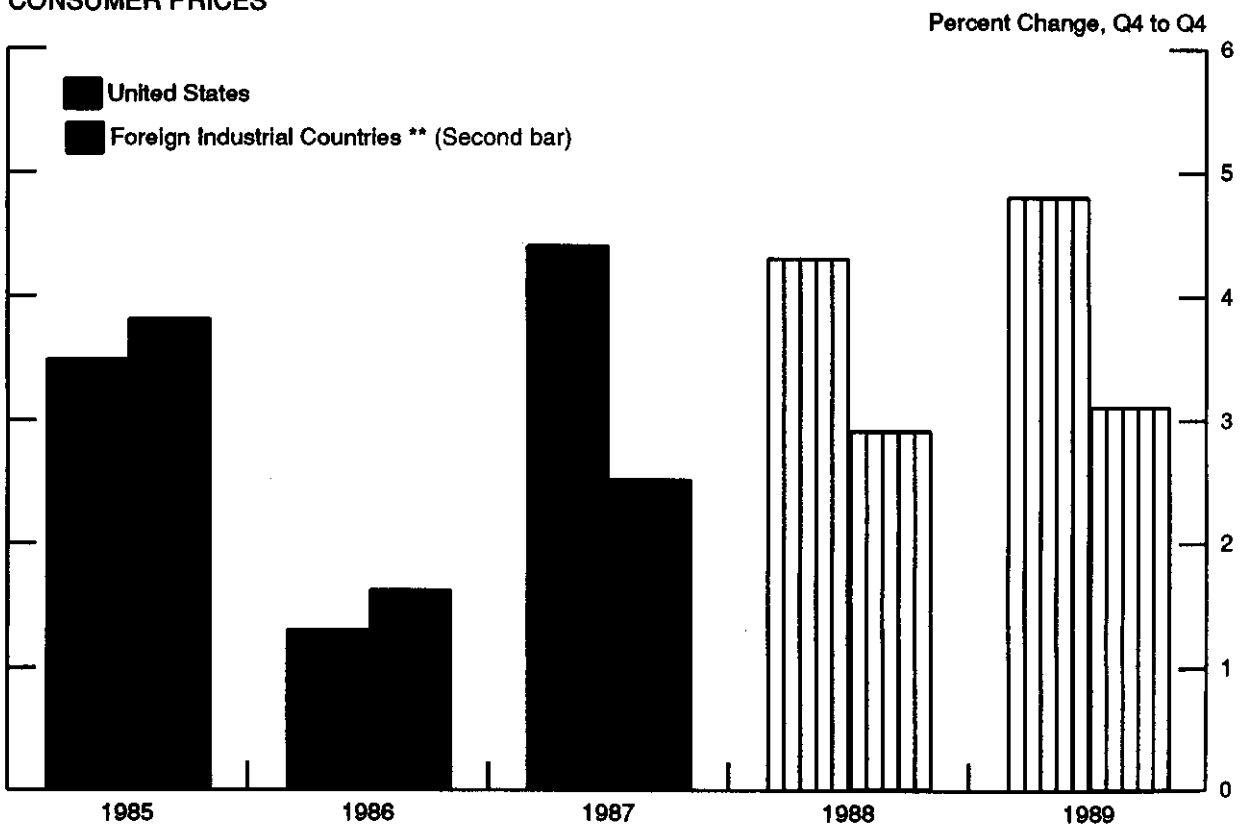


* Weighted average using 1982 GNP.

ECONOMIC ACTIVITY: WORLD



CONSUMER PRICES



* Weighted average using U.S. non-agricultural exports, 1978-83.

** Weighted average using 1982 GNP for the six major foreign industrial countries.

Volumes of Nonagricultural Exports*

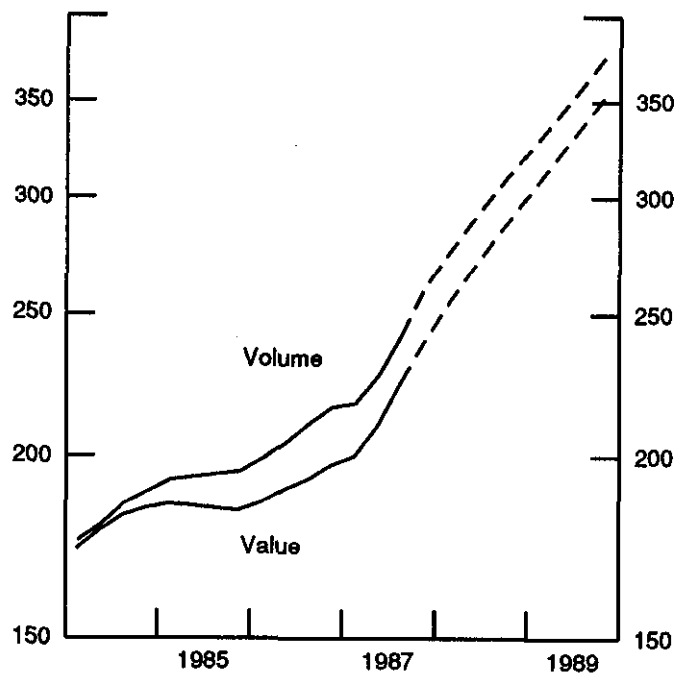
Percent change, Q4 to Q4

	1986	1987
1. Industrial Supplies	9	9
2. Capital Goods	13	29
Business machines	31	49
3. Automotive	-1	22
4. Consumer Goods	15	21
5. All Other	14	21
6. Total Nonagricultural	10	22

NONAGRICULTURAL EXPORTS*

Ratio scale,
billions of 1982 dollars

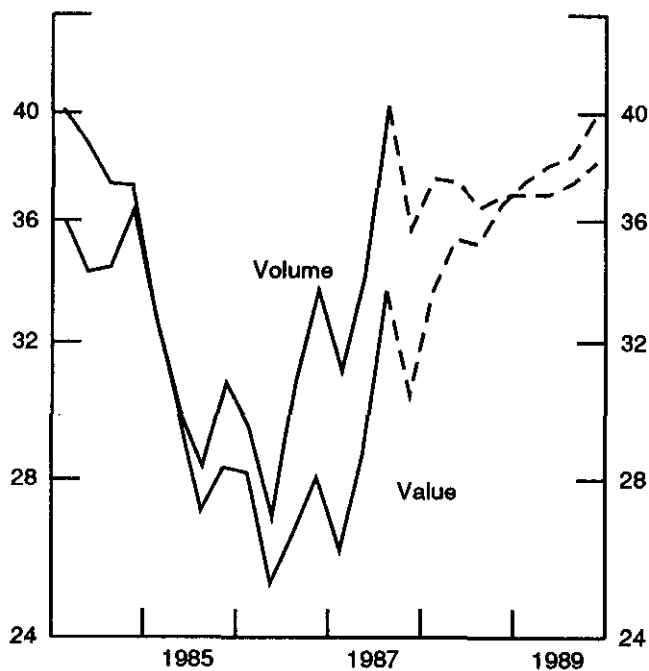
Ratio scale,
billions of dollars



AGRICULTURAL EXPORTS

Ratio scale,
billions of 1982 dollars

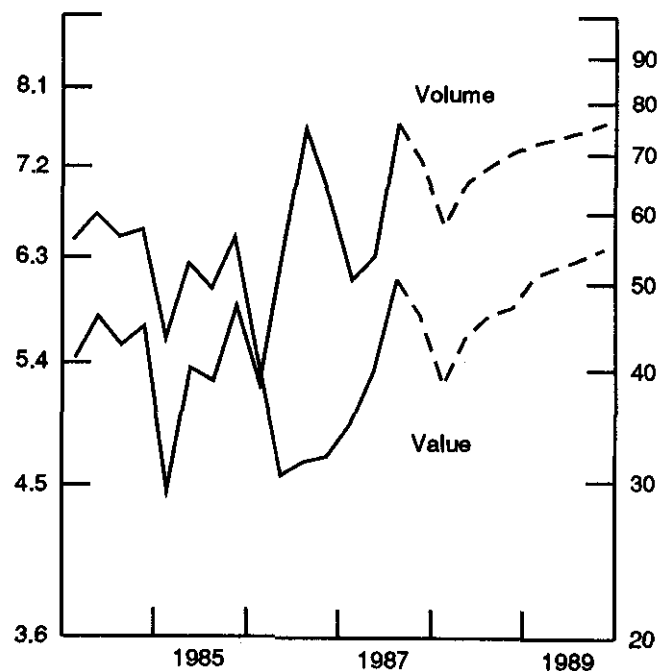
Ratio scale,
billions of dollars



OIL IMPORTS

Ratio scale,
MBD

Ratio scale,
billions of dollars



* Excluding gold.

Prices of Non-oil Imports Percent change, Q4 to Q4

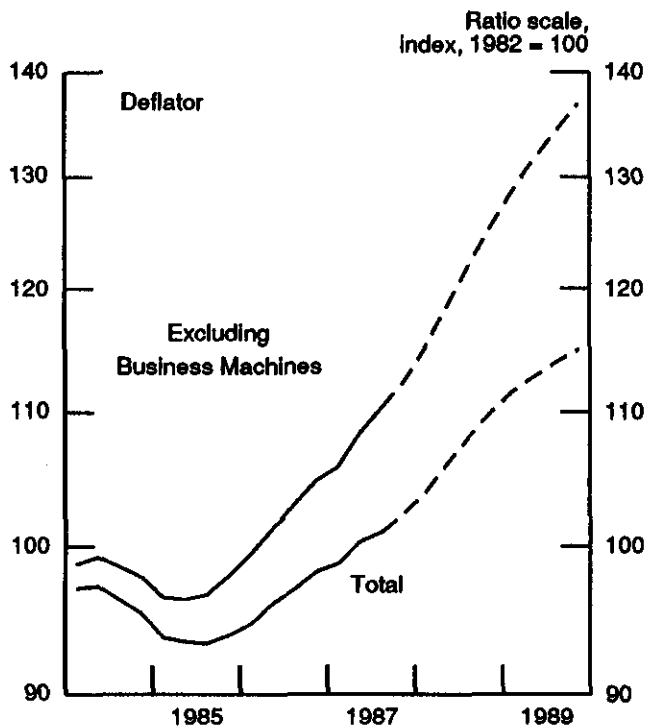
	1986	1987
1. Food	9	-3
2. Industrial Supplies	-1	11
3. Capital Goods	9	6
Business machines	-8	-9
4. Automotive	10	5
5. Consumer Goods	7	9
6. Total Non-oil	6	7

NIPA fixed-weighted indexes

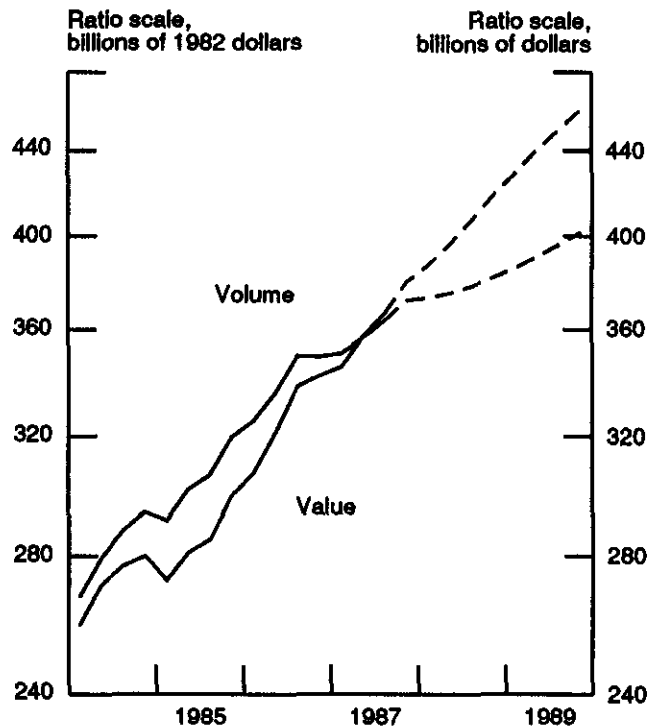
Volumes of Non-oil Imports* Percent change, Q4 to Q4

	1986	1987
1. Food	2	7
2. Industrial Supplies	9	-1
3. Capital Goods	16	19
Business machines	44	35
4. Automotive	5	4
5. Consumer Goods	12	-2
6. Total Non-oil	10	6

PRICE OF NON-OIL IMPORTS

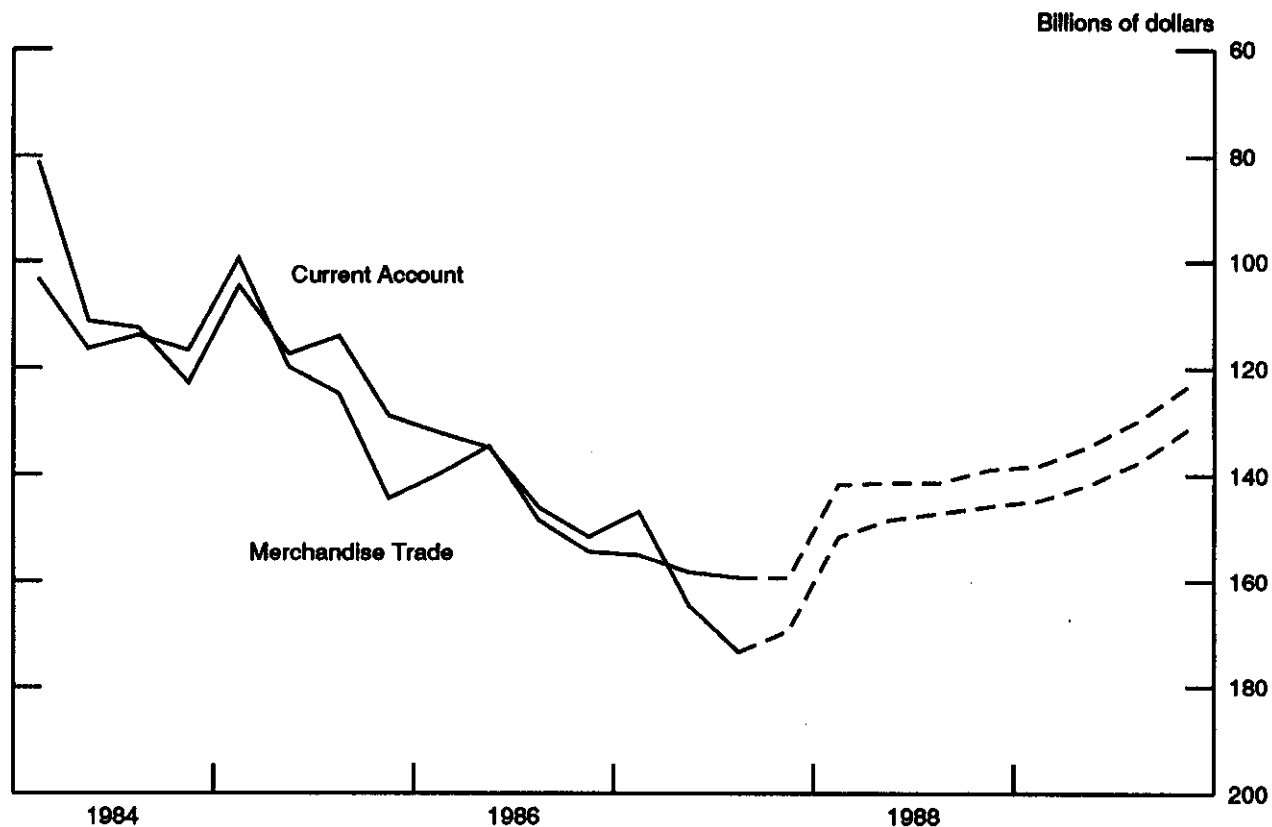


NON-OIL IMPORTS*



* Excluding gold.

EXTERNAL BALANCES



U.S. Capital Transactions

Billions of Dollars, Net Inflows = +				
	1985	1986	1987 ^e	1988 ^f
1. Private Capital, net	106	84	93	75
2. U.S. Banking Offices	40	18	47	30
3. Bonds and Stocks ¹	60	71	35	40
4. Direct Investment ¹	5	2	4	5
5. Other Flows	1	-7	7	0
6. Statistical Discrepancy	18	24	18	20
7. U.S. and Foreign Official Assets, net	-8	33	53	54
Memo:				
8. Current Account	-116	-141	-164	-149
9. U.S. and other G-10 Purchases of Dollars	-17	18	95	na
10. Estimated Total Net Official Accumulation of Dollar Assets	-10	42	152	na

1. Transactions with finance affiliates in the Netherlands Antilles have been excluded from direct investment and added to foreign purchases of U.S. securities.

Alternative Scenarios for the U.S. Economy

Percent change, Q4 to Q4, except as noted

	1988	1989
A. Staff Forecast		
1. Real GNP	2.1	2.8
2. Total Domestic Purchases	0.6	1.7
3. Consumer Prices	4.2	4.7
4. Current Account Balance ¹	-146	-131
5. Real GNP in Other G-10 Countries ²	1.9	1.9
B. Unchanged Dollar with Unchanged Policies		
Deviations from Forecast		
1. Real GNP	-0.1	-0.7
2. Total Domestic Purchases	0.1	0.2
3. Consumer Prices	-0.1	-0.8
4. Current Account Balance ¹	-1	-9
5. Federal Funds Rate ³	-0.1	-0.7
6. M2	0	0
7. Real GNP in Other G-10 Countries ²	0.1	0.5
C. Unchanged Dollar, Tighter U.S. Monetary Policy		
Deviations from Forecast		
1. Real GNP	-1.2	-3.3
2. Total Domestic Purchases	-1.2	-2.9
3. Consumer Prices	-0.1	-1.0
4. Current Account Balance ¹	8	14
5. Federal Funds Rate ³	2.3	3.0
6. M2	-2.0	-4.0
7. Real GNP in Other G-10 Countries ²	-0.1	-0.1

1. Billions of U.S. dollars. Q4 level.

2. Weighted average using total 1972-76 average trade.

3. Percentage points. Q4.